

D.T.E. 04-50

Petition of Dover Water Company, pursuant to G.L. c. 164, § 14 and G.L. c. 165, § 2, to incur long-term debt in the principal amount of up to \$250,000 from the Massachusetts Water Pollution Abatement Trust.

APPEARANCE: Jonathan Fryer, Esquire
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P.O. Box 16
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FOR: DOVER WATER COMPANY
Petitioner

I. INTRODUCTION

On May 13, 2004, Dover Water Company (“DWC” or “Company”) filed a petition (“Petition”) with the Department of Telecommunications and Energy (“Department”) requesting approval to incur long-term indebtedness up to \$250,000 from the Massachusetts Water Pollution Abatement Trust (“MWPAT”)¹ in the form of one or more state revolving fund (“SRF”) loans to be issued from time to time through the Massachusetts Department of Environmental Protection (“DEP”). The proposed SRF loan(s) will have a term of 20 years at an interest rate to be determined based on costs incurred by the SRF funding agency, MWPAT (Petition at 3).² DWC intends to use the proceeds of such issuances to partially fund the following projects: (1) a chlorination system serving a small distribution system recently acquired by DWC from Dover Waterworks;³ (2) a mains replacement program in the area formerly served by Dover Waterworks; (3) a new well supply referred to as the Francis Street Water Supply Project; and (4) an automatic back-up generator for an existing booster station⁴ (Petition at 4, Att. A). The Department docketed this matter as D.T.E. 04-50.

¹ MWPAT is a public instrumentality of the Commonwealth of Massachusetts initially established pursuant to St. 1989, c. 275, § 8 to administer the Water Pollution Abatement Revolving Fund authorized under Title VI of the Federal Clean Water Act (33 U.S.C. § 1251 et seq.). Pursuant to St. 1998, c. 78, § 9, MWPAT was further authorized to administer drinking water funding programs provided under Title XIV of the Federal Safe Drinking Water Act (42 U.S.C. § 300f et seq.).

² The borrower’s net debt service is structured to result in the financial equivalent of a loan with an annual interest rate of two percent (Exh. DTE-MWPAT-2, at 5).

³ DWC acquired the water supply system of Dover Waterworks in October 2003 (Tr. at 30). See Dover Waterworks v. Dover Water Company, D.T.E. 01-55 (2003).

⁴ Installation of the automatic back-up generator is pending DEP approval.

Pursuant to notice duly issued, the Department held a public and evidentiary hearing at the Department's offices on June 10, 2004. No petitions for leave to intervene were received. The Company presented two witnesses in support of its petition: Judith Wotton, president and treasurer of DWC, and Stephen B. Alcott, an independent consultant. The evidentiary record consists of 17 exhibits and two responses to Department record requests.⁵

II. DESCRIPTION OF THE PROPOSED FINANCING

MWPAT assists water suppliers in financing water pollution abatement projects, including water treatment facilities, through the state Water Pollution Abatement Revolving Fund established pursuant to G.L. c. 29, § 2L.⁶ See G.L. c. 29C, § 2. MWPAT is authorized to issue revenue bonds and apply the proceeds thereon, together with federal and state capitalization grants and other available funds, to make low-interest loans to communities, local government units, and public and private water suppliers for expenditures that will ensure a clean, abundant water supply and to provide responsible wastewater management (Exhs. DTE-MWPAT-4, at 36, 37; DTE 1-3). While MWPAT's financial and management activities are administered by employees of the State Treasurer's office, project oversight and direction is provided by the DEP (Exh. DTE-MWPAT-4, at 36). According to DWC, the

⁵ In addition, pursuant to 220 C.M.R. § 1.10(3), DWC's 2003 Annual Return to the Department ("2003 Annual Return") was incorporated into the record by reference (Tr. at 40-41).

⁶ Although the primary recipients of MWPAT assistance are publicly-owned water suppliers, investor-owned water systems may also qualify for MWPAT funding (Exhs. DWC-4B; DWC-4C at 2; DTE-MWPAT-4, at 8). See G.L. c. 21, § 27A; G.L. c. 29C, § 18; 310 C.M.R. §§ 45.00 et seq.

Company applied for SRF funding at the urging of DEP officials because the physical water system acquired from Dover Waterworks in 2003 was in poor condition and posed a potential public health threat (Exh. DTE 1-4). The DEP included DWC in MWPAT's 2004 State Revolving Fund Intended Use Plan for drinking water projects ("2004 IUP"), thereby making the Company eligible for MWPAT financing (Exh. DWC-4B).⁷

Each fall, MWPAT issues revenue bonds through its Pool Loan Program ("Pool Program Bonds") of sufficient value both to fund those water suppliers found by DEP to be eligible for financial assistance and to meet redemption requirements on outstanding bonds (Exhs. DTE-MWPAT-2, at 5; DTE-MWPAT-4, at 45-47). The proceeds received by MWPAT are invested primarily in United States government securities and guaranteed investment contracts, and the interest income is used to support the Pool Program Bonds and reduce the overall cost of financing to borrowers (Exhs. DTE-MWPAT-2, at 5-6; DTE-MWPAT-3, at 16; DTE-MWPAT-4, at 10). MWPAT's Pool Program Bonds have been rated AAA by both Fitch IBCA and Standard and Poor's, and have an Aaa rating from Moody's Investor's Service, Inc. (Exh. DTE-MWPAT-3, at 3). Consequently, MWPAT is able to provide financing to its borrowers at the lowest cost possible (id.).

⁷ DWC originally requested \$443,187 in funding through MWPAT (Petition at 4). This amount was included in DEP's 2004 IUP (Exhs. DWC-4B; DWC-4C). However, DWC was advised by its engineering consultants that the procedures required as a condition of SRF funding could increase project costs by as much as 130 percent (Exh. DTE 2-1; Tr. at 18-20). Assisted by DWC's engineers and DEP, the Company identified \$250,000 in project components where use of SRF funding was cost-effective (Exhs. DTE 1-1; DTE 2-1; Tr. at 17-19). DWC intends to finance the remaining project costs with non-SRF funds (Petition at 4; Exh. DTE 1-1).

The MWPAT loan to DWC will have a term of 20 years, with annual principal payments and semi-annual interest payments (Petition at 1; Exh. DTE-MWPAT-2, at 5; RR-DTE-1). Because disbursements under the MWPAT loan will be made as specific projects are completed, DWC is seeking authorization to enter into the loan from time to time through the completion of the last project, expected to occur in June 2005 (Petition at 1; Tr. at 34-35). The effective interest rate charged to DWC will be fixed, and equal to the average interest cost of the Pool Program Bonds associated with MWPAT's 2004 IUP, less any subsidies that MWPAT applies through the investment of equity funds or contract assistance payments from the Commonwealth of Massachusetts (Exh. DTE-MWPAT-2, at 5-6; RR-DTE-1). Although the interest rate to be paid by DWC has yet to be established, based on information from the State Treasurer's office, the projected interest rate is two percent (Petition at 1; Exhs. DTE 1-5; DTE-MWPAT-2, at 5). DWC considers this interest rate to be favorable to ratepayers because it is 500 to 700 basis points lower than other sources of capital available to the Company, which are currently in the range of 8.0 to 8.5 percent (Exh. DTE 1-4; Tr. at 13).

In addition to the interest charge, DWC is responsible for all issuance costs and an annual administrative fee of 0.075 percent on the outstanding principal balance (Exh. DTE-MWPAT-2, at 4).⁸ Additionally, DWC has been informed by MWPAT that, because the Company is a privately-held entity of small size and limited credit access, it may

⁸ Issuance and administrative costs will be financed as part of the loan agreement (Exh. DTE-MWPAT-2, at 4-5; Tr. at 26).

be required to obtain a letter of credit as a means to guarantee repayment (Exh. DTE 1-5, Supp. 1; Tr. at 11-13).⁹ If required by MWPAT, the Company anticipates paying an annual fee of not more than two percent of the principal balance of the loan for the letter of credit (Exh. DTE 1-5, Supp. 1; Tr. at 13).

III. CAPITAL STRUCTURE OF THE COMPANY

As of December 31, 2003, DWC's utility plant (including \$252,816 in construction work in progress ("CWIP")) was \$2,535,524 (Exh. DWC-1). After removing \$422,290 in accumulated depreciation, \$252,816 in CWIP, and \$207,083 in miscellaneous intangible investment,¹⁰ the Company's net utility plant in service was \$1,653,335 (Exh. DWC-3). Of this plant balance, \$1,174,657 represents contributions in aid of construction ("CIAC") (Exhs. DWC-2; DWC-3).

As of December 31, 2003, the Company reported a total capitalization of \$899,303, consisting of \$392,689 in notes payable and \$506,614 in common equity (Exh. DWC-2;

⁹ Unlike virtually all of MWPAT's other borrowers, DWC receives no state funding which could be intercepted by MWPAT in the event of a loan default (Tr. at 11).

¹⁰ The Company's miscellaneous intangible investment represents the retained earnings balance that existed on DWC's books at the time it converted from a proprietorship to a corporation in 1991 (Tr. at 30-31). DWC treated the balance as a goodwill item not eligible for inclusion in rate base (Tr. at 31). See Boston Gas Company, D.T.E. 03-40, at 323 n. 137 (2003).

2003 Annual Return at 205).¹¹ The Company's common equity consisted of \$196,710 in common stock and \$309,904 in retained earnings (Exh. DWC-2).

IV. STANDARD OF REVIEW

In order for the Department to approve the issuance of stock, bonds, coupon notes, or other types of long-term indebtedness¹² by a water company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14.¹³ Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.¹⁴ Colonial Gas Company, D.P.U. 84-96, at 5 (1984); see also Milford

¹¹ The Company's notes payable balance includes both short-term debt and a five-year note with an outstanding balance of \$234,689 issued pursuant to Dover Water Company, D.T.E. 99-13 (1999) (2003 Annual Return at 205). The note matured and the debt was converted to a demand note (Tr. at 32-33, 36-37; RR-DTE-2). Consequently, at present, DWC has no long-term debt in its capital structure.

¹² Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

¹³ The provisions of G.L. c. 164, § 14 are applied to water companies pursuant to G.L. c. 165, § 2.

¹⁴ The net plant test is derived from G.L. c. 164, § 16. When the Department approves an issue of new stock, bonds, or other securities by a gas, electric or water company, if it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories, or fossil fuel inventories owned by such company is less than its outstanding stock and debt, it may prescribe such conditions and

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Water Company, D.P.U. 91-257, at 4-5 (1992); Edgartown Water Company, D.P.U. 90-274, at 5-7 (1990); Barnstable Water Company, D.P.U. 90-273, at 6-7 (1990).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 842, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946) ("Lowell Gas"). In cases where no issue has been raised about the reasonableness of management decisions regarding the requested financing, the Department limits its G.L. c. 164, § 14 review to a determination of reasonableness of the Company's proposed use of the proceeds of a stock issuance. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence showing that its net utility plant (utility plant less accumulated depreciation) is equal to or in excess of its total capitalization. Berkshire Gas Company, D.T.E. 03-89, at 15-16 (2004); Colonial Gas

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requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16.

Company, D.P.U. 84-96, at 5. The Department has defined, or implicitly applied, a standard for total capitalization in treating of the net plant test. D.P.U. 84-96, at 5. The Department's definition of total capitalization is the sum of long-term debt, preferred stock, and common stock outstanding. D.T.E. 03-89, at 15-16; D.P.U. 84-96, at 5. Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

V. ANALYSIS AND FINDINGS

DWC intends to use the proceeds from the \$250,000 issuance of long-term debt for the purpose of funding necessary capital improvements and to pay down the credit line which was used to begin making some of these improvements (Petition at 4, Att. A; Exh. DTE 1-3; Tr. at 15-16). The Department has found that the expansion or replacement of utility plant is a legitimate purpose in meeting a company's service obligation. Witches Brook Water Company, D.T.E. 03-81, at 8 (2003); Fitchburg Gas and Electric Light Company, D.T.E. 01- 43, at 6 (2001); Dover Water Company, D.T.E. 99-13, at 5 (1999); East Northfield Water Company, D.P.U./D.T.E. 97-36, at 6 (1997). Additionally, the issuance of long-term debt to retire short-term debt, such as credit lines, is a legitimate purpose in meeting

a company's service obligation. Fitchburg Gas and Electric Light Company, D.T.E. 03-72, at 7; Berkshire Gas Company, D.T.E. 98-129, at 8 (1999).

The entire proceeds of the MWPAT loan will be used to finance construction (Petition at 4, Att. A). While customary utility practice is to rely on short-term debt to finance construction, and then issue long-term debt to retire the short-term debt, the Department is aware of the difficulties faced by small utility companies in obtaining access to the capital markets. Sheffield Water Company, D.T.E. 00-75, at 5 (2000); Blackstone Gas Company, D.T.E. 98-91, at 6 (1999); Generic Cost of Capital for Water Companies, D.P.U. 96-90-A at 8-9 (1997). The subsidized nature of the MWPAT loan, with a projected effective interest rate of two percent,¹⁵ compares favorably with traditional financing sources, such as banks or insurance companies. Aquarion Water Company of Massachusetts, D.T.E. 02-57, at 7 (2002). Even with the potential costs associated with obtaining a letter of credit, the Company has demonstrated that it would be unable to obtain either short-term or long-term debt with more favorable terms than those available through MWPAT (Exh. DTE 1-4; Tr. at 13). Moreover, the lower interest rate associated with the MWPAT loan will be incorporated into the Company's capital structure as part of its next rate case proceeding pursuant to G.L. c. 164, § 94, likely benefitting DWC's ratepayers through a lower overall cost of capital to be

¹⁵ The actual interest rate cannot be determined until the project is permanently financed with proceeds of bonds issued by MWPAT (Exh. DTE-MWPAT-2, at 3). However, MWPAT has provided the Company an estimate of the total debt service on the principal amount of the loan being issued (id.; RR-DTE-1).

determined at the time of that future proceeding.¹⁶ D.T.E. 02-57, at 7; see Pinehills Water Company, D.T.E. 01-42, at 17-18 (2001); Assabet Water Company, D.T.E. 95-92, at 31 (1996).

Based on the foregoing, the Department finds that the issuance of a long-term loan for a term of 20 years in the principal amount of up to \$250,000, with an interest rate to be determined based on interest costs incurred by MWPAT as the SRF funding agency, is reasonably necessary to accomplish legitimate purposes in meeting DWC's service obligations, namely to finance costs associated with: (1) a chlorination system serving a small distribution system recently acquired by DWC from Dover Waterworks; (2) a main replacement program in the area formerly served by Dover Waterworks; (3) a new well supply referred to as the Francis Street Water Supply Project; (4) an automatic back-up generator for an existing booster station; and (5) loan origination and issuance costs.

Although the actual interest rate of the loan cannot be determined until the project is permanently financed with proceeds of bonds issued by MWPAT, the stated mission of MWPAT is "the provision of financial assistance, in the manner contemplated by Title VI of the Clean Water Act, to local governmental units as beneficiaries of the trust to finance the costs of water pollution abatement projects." G.L. c. 29C, § 3. This public mission requires MWPAT to provide funding to water and wastewater providers with favorable terms that may be unavailable through other lending sources. MWPAT has projected an effective interest rate

¹⁶ By way of comparison, the overall cost of debt used in the Company's previous rate settlement can be mathematically derived as 8.25 percent. Dover Water Company, D.T.E. 99-53, at 2 (1999).

of two percent (Exh. DTE 1-5). The Department is persuaded that the actual interest rate of the loan will not vary significantly from this projection, and that the rate itself is advantageous to DWC and its ratepayers. The Company shall provide the Department with the actual effective interest rate associated with the MWPAT loan within 30 days after the execution of the final loan documents.

The record demonstrates that, after the issuance of up to \$250,000 in long-term debt, DWC's total common stock and long-term debt of \$446,710 (\$196,710 plus \$250,000) will not exceed the Company's net utility plant (excluding CIAC) of \$478,678 (Exh. DWC-3). Accordingly, the Department finds that the Company's issuance of up to \$250,000 in long-term debt meets the net plant test as provided in G.L. c. 164, § 16.

Issues concerning the prudence of the Company's capital program have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that these projects are economically beneficial to the Company or its customers. The Department's determination in this Order shall not in any way be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, the Department

VOTES: That the execution of a 20-year loan by Dover Water Company in the aggregate principal amount of up to \$250,000, with an interest rate to be determined based on interest costs incurred by MWPAT, as the SRF funding agency is reasonably necessary to

accomplish some legitimate purpose in meeting Dover Water Company's service obligations;
and it is

ORDERED: That Dover Water Company shall be authorized to enter into a
20-year loan in the aggregate principal amount of up to \$250,000 with an interest rate to be
determined based on interest costs incurred by MWPAT, as the SRF funding agency; and it is

FURTHER ORDERED: That the proceeds from such issuance of debt shall be used for
the purposes as set forth herein; and it is

FURTHER ORDERED: That Dover Water Company follow all other directives
contained in this Order; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

Paul G. Afonso, Chairman

James Connelly, Commissioner

W. Robert Keating, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).